Shermag inc.

2001 | 2002 ANNUAL REPORT

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OUR mission

Shermag's corporate mission is to produce the highest quality furniture available in the marketplace. While fully aware of the importance of assuring the Company's shareholders a positive return on their investment, Shermag's management is also concerned about offering fair working conditions to its 2,000 employees.

COMPANY profile

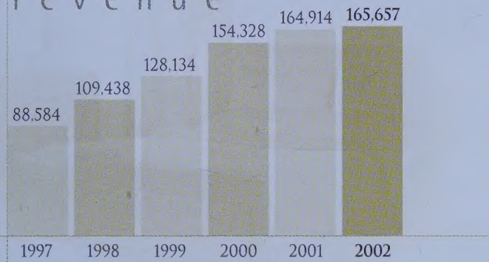
Shermag is a leader in the production and distribution of high-quality residential furniture. The Company enjoys an enviable reputation in the North American market and figures prominently in the design of contemporary-style furniture.

Shermag's facilities include a network of medium-size factories equipped with state-of-the-art technology. Vertical integration – from the forest to the retailer – gives the Company an exceptional competitive edge in a highly fragmented industrial sector. Three hardwood sawmills, a plant specializing in the fabrication of components, and a veneer plant all contribute to the efficiency of the Company's ten furniture manufacturing facilities and to a lowering of production costs.

Shermag focuses on specific markets in the sale of its products. Major department stores in the United States and Canada, multiple-location chain stores specializing in the distribution of high-end furniture, as well as the best independent retailers comprise the Company's marketing targets.

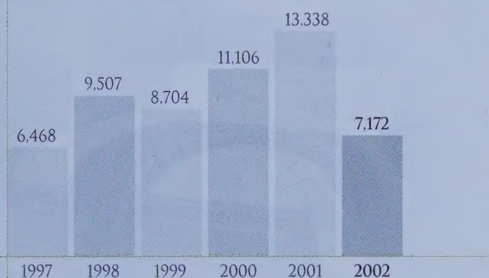
FINANCIAL highlights

GROSS revenue



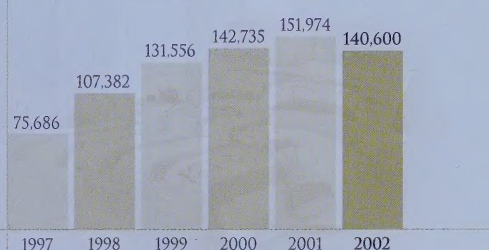
COMPOUND GROWTH RATE OVER FIVE YEARS:13.3%

NET earnings



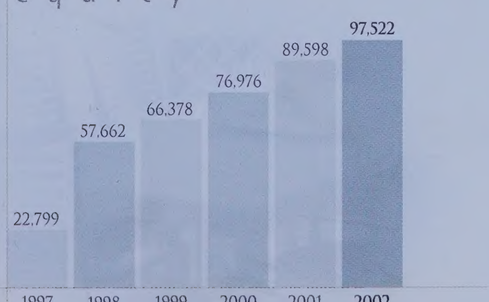
COMPOUND GROWTH RATE OVER FIVE YEARS: 2.1%

TOTAL assets



COMPOUND GROWTH RATE OVER FIVE YEARS: 13.2%

SHAREHOLDERS' equity



COMPOUND GROWTH RATE OVER FIVE YEARS: 33.7%

15 02	March 30 2001	March 31 2000	April 2 1999	April 3 1998
57	164,914	154,328	128,134	109,438
97	153,746	144,391	120,594	103,887
45	128,821	123,444	100,245	81,887
%	78%	80%	78%	75%
98	48,436	46,319	38,383	34,025
36	19,731	16,665	13,105	13,098
18	28,744	25,373	19,519	18,256
72	13,338	11,106	8,704	9,507
24	13,184,474	13,208,774	13,284,674	13,282,674
54	1.01	0.84	0.66	0.78
54	1.00	0.83	0.66	0.78
30	6.76	5.79	4.96	4.31
25	7.00	7.00	9.30	18.25
.7x	7.0x	8.4x	14.1x	23.4x
00	151,974	142,735	131,556	107,382
15	45,426	37,299	31,057	32,969
89	10,726	12,205	13,224	12,760
22	89,598	76,976	66,378	57,662
20	20,538	17,912	14,186	12,252
%	29.37%	30.01%	29.96%	31.09%
%	8.09%	7.20%	6.79%	8.69%
%	17.43%	16.44%	15.23%	16.68%
:1	2.11:1	1.84:1	1.71:1	2.02:1
:1	0.12:1	0.16:1	0.20:1	0.22:1
%	16%	16%	14%	24%

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FINANCIAL highlights

Year ended (in thousands of dollars, except ratios and per share data)	April 5 2002	March 30 2001	March 31 2000	April 2 1999	April 3 1998
Operating results					
Gross revenue	165,657	164,914	154,328	128,134	109,438
Net revenue	152,797	153,746	144,391	120,594	103,887
Exports	119,745	128,821	123,444	100,245	81,887
Exports as % of gross revenue	72%	78%	80%	78%	75%
Gross profit excluding depreciation and amortization	44,998	48,436	46,319	38,383	34,025
Earnings before income taxes	11,036	19,731	16,665	13,105	13,098
Earnings before interest, taxes, depreciation and amortization (EBITDA)	20,218	28,744	25,373	19,519	18,256
Net earnings	7,172	13,338	11,106	8,704	9,507
Common shares outstanding at year end	13,292,724	13,184,474	13,208,774	13,284,674	13,282,674
Earnings per share results					
Net earnings	0.54	1.01	0.84	0.66	0.78
Diluted net earnings	0.54	1.00	0.83	0.66	0.78
Book value	7.30	6.76	5.79	4.96	4.31
Market price	12.25	7.00	7.00	9.30	18.25
Price earnings ratio	22.7x	7.0x	8.4x	14.1x	23.4x
Financial situation					
Total assets [1]	140,600	151,974	142,735	131,556	107,382
Working capital	55,015	45,426	37,299	31,057	32,969
Long-term debt	9,289	10,726	12,205	13,224	12,760
Shareholders' equity	97,522	89,598	76,976	66,378	57,662
Cash flow from operations	14,520	20,538	17,912	14,186	12,252
Ratios and returns					
Gross margin	27.16%	29.37%	30.01%	29.96%	31.09%
Net profit margin	4.33%	8.09%	7.20%	6.79%	8.69%
EBITDA margin	12.20%	17.43%	16.44%	15.23%	16.68%
Current ratio [1]	3.38:1	2.11:1	1.84:1	1.71:1	2.02:1
Long-term debt ratio	0.09:1	0.12:1	0.16:1	0.20:1	0.22:1
Return on equity	8%	16%	16%	14%	24%

[1] After reclassification of accruals for advertising and volume rebate in deduction of accounts receivable

MESSAGE to shareholders

A YEAR OF CHANGE AND CHALLENGES

Fiscal 2001-2002 marked my first full year as President and Chief Executive Officer of Shermag. I am delighted that in my first message to you in this capacity, I am able to report significant accomplishments for the Company. An almost doubling of our share price during the fiscal year reflects a growing confidence in the Company's plans and initiatives. This, despite a challenging year for almost every business sector, as well as issues that were specific to Shermag - issues that were tackled head on and, in large measure, resolved.

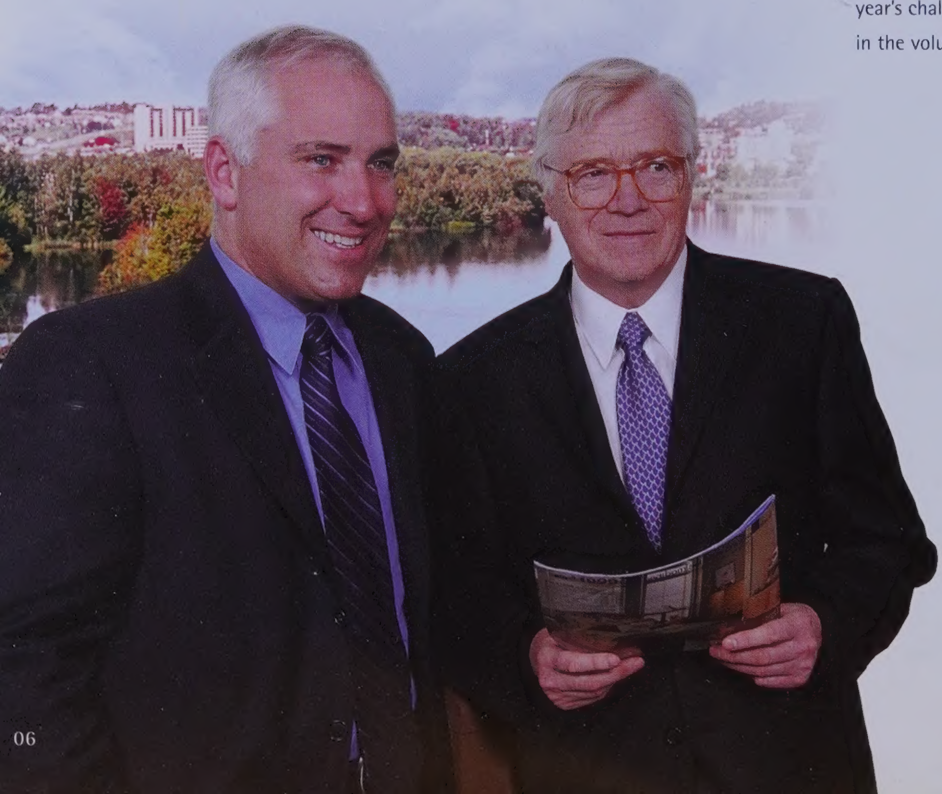
After years of buoyant economic growth, the U.S. economy faltered and then briefly slipped into a recession. Coupled with the tragedies of September 11th, this seriously curtailed consumer spending. One of the victims of this downturn was a major Shermag customer, HomeLife, a top 100 U.S. furniture retailer. HomeLife's bankruptcy resulted in a loss of some $13 million in sales for Shermag, directly affecting a number of our divisions which produced their casual dining and bedroom collections.

Less dramatic, but nonetheless important setbacks, included a five week strike at our Disraeli plant and weaker performances at Nadeau and Sofas International.

Collectively, Shermag rose to all of these challenges, finishing the year with sales levels higher than the previous year. This was accomplished with growth in our independent furniture store channel of distribution as well as a stronger than anticipated Canadian market. While the overall sales performance is something to be proud of, it certainly does not allow for complacency. We can and must do even better this year.

THE SHERMAG MODEL PREVAILS

Our proven marketing strategy is based on granting territorial exclusivity to leading retailers for Shermag collections and delivering fashionable, sellable styles at great values. This enabled the Company to not only overcome the year's challenges, but also resulted in an increase in the volume of shipments.



On behalf of the members of the Board of Directors, I would like to express our heartfelt thanks and our deepest gratitude to Serge Racine who retired last December from the Company he founded 25 years ago.

His talent, relentless efforts and vision led to building a single-product manufacturer into the world-class organization Shermag has become today. With 2,000 workers committed to the Company's success, Shermag has reached sales levels of nearly $200 million and is expanding. The Company has great ambitions for its future and I wish to assure our President and Chief Executive Officer, Jeffrey Casselman, that he has the complete confidence of the Board of Directors in his capacity to bring Shermag to new heights.

Our sincere thanks to Serge Racine
and our best wishes of success
to Jeffrey Casselman.

Claude Pichette
Chairman of the Board

Serge Racine
Founder of Shermag

‹ETURNS TO PROFITABILITY

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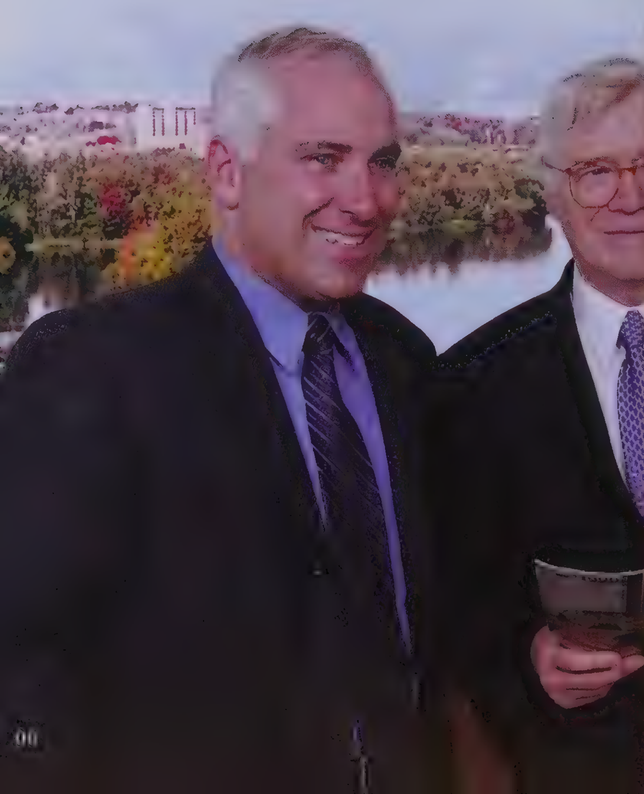

Shermag grew while most of its competitors lost ground. We had been closely monitoring HomeLife's weakened financial position for several months before the actual bankruptcy filing and were aggressively engaged in identifying new placements for the affected collections. This foresight and the strength of the Canadian market allowed for the replacement of the lost sales.

Dealing with the unpredictability of HomeLife through the first half of fiscal 2001-2002 reduced sales and also created operational inefficiencies at certain factories. In an effort to minimize exposure, production and shipments were often stopped and re-started, creating a negative impact on margins.

However, the initiatives to penetrate other retailers worked. Evidence of this was the dramatic reversal at the Bédard Division. While almost overnight, the division lost a significant percentage of its business due to the HomeLife bankruptcy, by year-end it finished ahead of the previous year.

SAWMILL SECTOR RETURNS TO PROFITABILITY

Going into the 2001 fiscal year, the Company's sawmill operations were underperforming and were creating downward pressure on margins. A turnaround committee was established to correct the negative impact of procurement decisions made the previous year which resulted in excess higher-cost log and lumber inventories. Corrective measures taken included new management, a temporary suspension of Shermag's Maine sawmill and the establishment of a more efficient purchasing system. The plan was to return the sector to profitability by the third quarter. That is precisely what occurred.

ADDING NEW COLLECTIONS

Shermag's partners rely on us for our consistent ability to design and produce exciting collections. New, innovative products are a significant competitive edge. After several years of success with existing collections, an unprecedented number of new collections were introduced this past year. An example of this has been the aggressive development of new collections featuring a combination of leather and wood in bedroom furniture, sofas, and chairs. Consumers have responded enthusiastically to these products.

This will enable Shermag to expand its strategy of territorial exclusivity and to penetrate additional retail sectors. These added collections will allow us to focus on regional store chains and the independent furniture store channel, retail sectors that hold considerable potential for Shermag. During the year, Jeff Schwall was named Vice-president, U.S. Sales. His strong industry background with these specific retail sectors will allow us to penetrate the U.S. market more thoroughly.

MESSAGE to shareholders

Our proven marketing strategy enabled the Company to overcome the year's challenges, and resulted in an increase in the volume of shipments. We grew even while most of our competitors did not.

NEW IMPORT DIVISION

Another important marketing initiative during the year was the creation of a new division to import finished furniture. We have tapped the expertise of Company veteran, Jerry Zelnicker, to lead this endeavour. This program has allowed us to introduce new collections featuring more detailed designs, in contrast to the clean, casual, contemporary lines that characterize Shermag's domestic collections. Overseas manufacturers following Shermag's exacting specifications will produce these more intricate items which require a higher labour component.

This plan will augment rather than replace North American production. Not only does this help us meet the challenge of overseas competition, but it has also enabled us to serve larger parts of the North American market and to build stronger relationships with existing partners. Importantly, our new collections received a very positive response by major partners at the April High Point Furniture Market. I invite you to read our Review of Operations for additional information.

ATTENTION TO DETAIL

We have built a stronger, deeper management structure, committed to more detailed attention to operations and to improved cost controls. With an eye to cash flow management, we reduced the increasing trend in capital spending, avoiding any major commitments to build, expand or acquire production facilities. Instead, we have developed a plan to more fully utilize existing facilities through the addition of night shifts at certain plants to increase capacities.

Inventory controls, better planning and low purchasing led to a notable reduction in debt by some $16 million. Our domestic divisions, which operate on a semi-autonomous basis, have been decentralized yet further to achieve a clearer focus on specific products and as such, enhanced results. This resulted in the decision to separate HPL from the Nadeau Division, both of which produce bedroom furniture.

LOOKING FORWARD

We have made doing more from existing operations a priority in our business plans. An example of this is smaller divisions that more deeply involve management in operations and can produce better results. This positions these existing operations for the organic growth that Shermag is surely capable of achieving.

This organic growth will be fueled by the efforts we have begun to broaden Shermag's distribution into additional retail sectors. While much progress has been made, it is only a start. Shermag will continue to focus on developing these sectors in the seasons to come.

A second priority has been the new import initiative. This is only the first step in leveraging existing channels of distribution by offering new product categories like traditional styled furniture.

A year ago, we set a course for a more conservative approach to investment, better inventory control and increased cash from operations to strengthen the balance sheet. I am pleased to say that, despite the challenges, we have met all of these objectives. We are now in a better position to take advantage of new investment possibilities. While there is no need for haste, we remain open to suitable opportunities as long as they meet a serious list of criteria.

There are signs of recovery in the U.S. economy. It is our hope that this will relieve the pressure on margins that we have experienced over the past year. We have seen that surprises are a way of life. I am confident that Shermag has established solid initiatives to overcome any negative industry trends. Yet, we can take nothing for granted and must remain flexible and intelligent in how we do things.

A CHANGING OF THE GUARD

Shermag enters its second quarter-century of achievement under new leadership. Serge Racine retired as Chairman December 31, 2001. Serge founded Shermag 25 years ago and built it into a world-class organization. As we greet the future with an enhanced and expanded product line, we continue to build on the Company's established reputation among retailers and consumers for style, quality and exceptional value.

We wish Serge well and welcome Claude Pichette as our new Chairman. Claude has been a member of the Board since 1989 and has been on the Executive Committee since 1998. Claude has held several key positions in Québec's public and para-public sectors and has a solid financial and academic background. Claude is supported by our excellent Board of Directors, each of whom has provided important guidance and support through the year.

I take this opportunity to thank all Shermag employees for so warmly welcoming me as their President and CEO. This year's annual report portrays members of the Shermag team at our various facilities. These images symbolize the extra effort and commitment that the many hardworking men and women of Shermag make regularly on behalf of our valued customers. I am grateful for their dedication and for the skills they have so clearly demonstrated. A final note of thanks to our customers whom we consider our partners and to our shareholders, whose loyalty is well appreciated.

Jeffrey K. Casselman
President and Chief Executive Officer

REVIEW of operations

The furniture chain category offers excellent opportunities. Additional collections will expand the Company's product lines and open the way to new floor placements with major retailers.

THE VALUE OF THE SHERMAG MODEL

Shermag's strategy of granting retailers territorial exclusivity for specific collections continued to prove its worth during the year. Furniture shipments grew in the last fiscal year despite a weak economic climate and the bankruptcy of a major customer. In addition, new collections were developed in the Company's various divisions that will allow for a broadening of this successful strategy well into the future.

The collapse of the HomeLife furniture chain in the U.S. caused serious short-term difficulties at certain divisions, but the Company's proactive nature and its ability to replace the lost sales limited the damage.

The example of Shermag's Bédard Division is a strong success story in this regard. As a result of the HomeLife situation, the division lost a significant percentage of its business. Bédard management, however, had recognized the growing and unhealthy dependence on HomeLife more than a year ago. New collections and additions were developed and the selling process was begun even before HomeLife closed its doors. As a result, the division ended the fiscal year with an increase in total sales. With the recent successful launch of Expresso, a new step-up casual dining collection, another strong increase is anticipated in 2002-2003.

A STRONG NETWORK OF RETAIL PARTNERS

The network of retail partners through which Shermag distributes its products is divided into four main categories: top department store groups, major regional furniture chains, national retail chains and independent furniture stores. The department store category has performed especially well for Shermag. During the year, more floor space was allocated to the Company's products, a recognition of Shermag's ability to provide the right products at the right price.

The regional furniture chain category offers excellent opportunities. Additional collections will expand the Company's product lines and open the way to new floor placements with major retailers. This will be an effective means of widening the account base and more thoroughly penetrating this sector.

Shermag has consistently placed a special emphasis on design. This has helped create the excellent reputation the Company enjoys today. Recognized for its fashion forward collections, the Company is a leader in both transitional and casual contemporary styling. Typical of this are new collections that marry leather and wood, combining the glamour and fashion styling of soft leather with the warmth and natural appeal of quality hardwoods. The leather-and-wood combination is being used in sofas, chairs, and beds as well as some bedroom case pieces.

REVIEW of operations

NEW IMPORT INITIATIVE

A strategic move during the year was the creation of a new division to import finished furniture. U.S. manufacturers have increasingly been looking to Asia for the production of traditional styled furniture where there is significant design detail and more intensive labour content. This is an opportunity for Shermag to build on its exclusive distribution strategy by bringing a new product category to its existing customers.

Much progress has been made since this project was first announced last summer. During the course of the year, two new collections were designed, a supply chain was established including manufacturing facilities, logistics and quality control functions. Collection prototypes were produced and presented during the Spring High Point Furniture Market.

The reaction to these products has been extremely positive with significant commitments from the Company's major retail partners. Additional collections have been designed and are being executed for showing in the fall selling season.

Global sourcing is an effective way of leveraging the existing distribution channel by adding a new product category without committing to significant new infrastructure. This initiative also serves to extend the loyalty of the existing retail partner base and to help broaden the product assortment for expanding distribution to new customers.

STRONG REBOUNDS AT THE DIVISIONAL LEVEL

Vertical Integration

Shermag began the year with significant challenges in its sawmill operations. The Company was faced with excess capacity, a difficult procurement contract and purchasing environment as well as an inexperienced management team. Some of the effects of this situation were excess log and lumber inventories as well as reduced margins.

Early in the year, a committee was established to oversee and improve the performance in this sector. A plan was developed and implemented which included recruiting new, experienced management, the temporary shutdown of the Maine facility and an improvement to the log procurement process. The Maine shutdown was an important factor that allowed new management to focus on fewer operations. This decision also reduced supply, creating lower inventory levels, reduced the log purchasing requirements and allowed for more stringent purchase specifications.

Sawmill operations returned to normal efficiency and profitability levels in the fourth quarter. While a difficult learning experience, these challenges led to organizational changes which create the potential for continued improvements in the coming years.

The Placages Lennox veneer plant experienced a challenging yet successful year. Following a significant investment to increase capacity the previous year, the challenge was to add new staff while maintaining the necessary service, quality and efficiency levels. During the course of the year, production volumes were increased and margins were improved year over year. Significant effort was made during the year to improve planning and communication between the furniture factories and this facility to ensure efficient delivery and proper management of the supply chain.

With its ever-improving capacity of high quality veneer products, Placages Lennox is now positioned to seek customers outside Shermag and create a new source of revenue for the Company.

SHERMAG'S OPERATIONS AT A GLANCE

RAW MATERIALS

Production unit	Specialization	Plant location
Placages Lennox	Veneer components	Canton Eaton (QC)
Mégabois (1989) Inc.	Sawmill	Lac-Mégantic (QC)
Scierie Montauban Inc.	Sawmill	Notre-Dame-de-Montauban (QC)
Shermag Corp. dba Woodtek	Sawmill (temporarily closed)	North Anson (ME, USA)

FURNITURE

Production unit	Specialization	Plant location
Bédard	Dining room furniture	Saint-Étienne-de-Lauzon (QC), Granby (QC), Bécancour (QC)
Chandéric / Conant Ball	Glider rockers	Canton Eaton (QC)
HPL	Bedroom furniture	Victoriaville (QC)
Nadeau	Bedroom furniture	Saint-François-de-Madawaska (N. B.), Edmundston (N. B.)
Scotstown	Bedroom and dining room furniture, and occasional furniture	Scotstown (QC), Bishopton (QC), Disraeli (QC)
Sofas International S.I. Inc.	Upholstered furniture in fabric and leather	Saint-Léonard (QC)

REVIEW of operations

Reaction to the new import initiative has been extremely positive with significant commitments from the Company's major retail partners. Additional collections have been designed and are being executed for showing in the fall selling season.

Furniture Sector

Each of Shermag's furniture divisions concentrates on the production of specific collections and operates on a semi-autonomous basis, with its own plans, budgets and profitability measurement. This structure ensures that Shermag maintains the vitality of small, fast entrepreneurial organizations backed by the strength and resources of a larger group.

The Scotstown Division performed well during 2001-2002. Faced with strong demand for the key Bourbon Street and Florence collections, divisional management focused on service, as well as capacity and efficiency improvements. Despite the labour dispute at the Disraeli production facility in June-July, the Scotstown Division ended the year very close to achieving both its sales and profitability plans.

The Bédard Division, as previously discussed, overcame significant challenges arising from the loss of its largest customer, HomeLife, to achieve significant growth and improved profitability. Both the table and chair plants achieved their profitability plans. However, inefficiencies at the Bécancour factory kept the division from achieving its overall profitability plan for the year. The Bécancour factory processes the wood derived from the Company's Timber Supply and Forest Management Agreements and provides the division's other plants with raw material in the form of glued wood panels.

The Nadeau Division faced a difficult year due to a combination of the lost HomeLife business, key staff changes and disruptions brought on by the need to aggressively develop new collections. New collections and new clients for its bedroom furniture allowed the division to finish the year with positive momentum. A program of cost reductions and proactive marketing should help Nadeau meet its targets for 2002-2003.

The HPL Division continued to underperform expectations in 2001-2002. While demand for its products remained strong with growth in both the Héritage and Orléans collections, the division fell short of production volume plans. In order to meet demand, this shortfall forced the transfer of production to other facilities. In April, the decision was made to separate HPL from the Nadeau Division and concentrate new management solely on the HPL operations in order to improve this situation.

The Chandéric Division, the maker of Shermag's glider rockers, also performed well despite uncertain conditions. While inventories were being curtailed at the retail level, a strong backlog helped the division maintain sales levels. Improved production efficiencies in the plant allowed the division to achieve its profitability plans for the year. For the current fiscal year, plans are in place to add independent juvenile retailers to enlarge its client base.

Sofas International manufactures upholstered furniture including chairs, sofas and loveseats in leather and fashion fabric covers under the Shermag and Caméléon labels. The division experienced a disappointing year. Despite being significantly affected by the loss of the HomeLife upholstered chair business, Sofas International managed sales marginally above prior year levels. However, profitability was well below the figures achieved last year.

MANAGEMENT'S DISCUSSION AND ANALYSIS of operating results and financial position

In keeping with its plan to strengthen its balance sheet, the Company reduced bank loans and acceptances by $14.4 million and long-term debt by $1.5 million during fiscal 2001-2002.

The purpose of this analysis of the Company's financial position and operating results is to provide the reader with an overview of how the financial position changed between March 30, 2001 and April 5, 2002. It also compares the operating results and cash flow for the quarter and twelve-month period ended April 5, 2002 to those for the same periods the previous year. This analysis should be read in conjunction with the Company's consolidated financial statements dated April 5, 2002 and the notes thereto.

CORPORATE OBJECTIVES, CORE BUSINESS AND STRATEGIES

Overview

Shermag's goal is to produce the highest quality furniture available in the marketplace while offering fair working conditions to its employees.

Initially, the Company manufactured glider rockers. However, over the years, through the acquisition of various companies, Shermag expanded its product line to include dining room and bedroom furniture, as well as occasional and upholstered furniture. Except for its upholstered furniture, the Company's products are made of solid wood and veneer supplied mainly by the Company's sawmills and veneer plant.

The Company has a workforce of nearly 2,000 employees and operates ten residential-furniture manufacturing plants, a wood-component plant, a veneer plant, three sawmills, a wood by-products plant and two distribution centres. With the exception of one sawmill and the wood by-products plant located in North Anson, Maine in the United States, all the Company's facilities are in Canada, in the provinces of Québec and New Brunswick.

Operating and Growth Strategy

Over the years, Shermag has succeeded in offering high quality products at very competitive prices. This is the direct result of its vertical integration strategy, which allows the Company tight control over its supply of raw materials. More than 90% of the hardwood and 80% of the veneer it uses is produced at its own facilities, ensuring greater price stability for its raw material and protecting it from sudden, significant price fluctuations similar to what the market experienced during the recent fiscal years. By controlling its sources of supply in this way, Shermag is also able to provide for the particular needs of its factories in terms of the dimensions and types of components, thus optimizing raw-material utilization. The Company remains solidly committed to this approach, which has afforded it sustained growth and profitability.

Shermag now achieves almost 72% of its sales in the United States. This is due to its high quality, original products and its effective marketing strategy. Shermag's marketing strategy is based on a segmentation of the market into four specific categories: top department store groups, major regional furniture chains, national retail chains and independent furniture stores, along with a commitment to supply its customers with quality products on an exclusive basis within their trading areas. The exclusivity concept ensures control over the distribution of its products in a given territory and provides higher profit margins for its business partners.

Segments

Shermag's activities are divided into two sectors: furniture and sawmill operations.

The furniture sector comprises the manufacturing and distribution of household furniture, including bedroom and dining room sets, glider rockers, occasional tables and wall units, and upholstered living room furniture. This sector operates ten furniture-manufacturing plants and two additional plants that specialize in wood and veneer components.

# of operating results and financial position

The sawmill sector consists of the Company's three sawmills, Mégabois (1989) Inc., Scierie Montauban Inc. and Shermag Corp. dba Woodtek, which supply approximately 70% of the hardwood requirements of the Group's furniture plants. Sawmill products unsuitable for furniture manufacturing are sold to companies specialized in finishing trim, floorboard and other related products.

As the primary purpose of the sawmill sector is to provide a reliable supply of raw material at advantageous prices for the Company's furniture plants, the Company's financial results are not presented by segment.

RESULTS OF OPERATIONS

Overview

It should be noted that results for the 2001-2002 fiscal year are for a 53-week period, while fiscal 2000-2001 covered the usual 52 weeks. Likewise, the fourth quarter results are for a 14-week period while the same period in 2000-2001 covered 13 weeks.

The 2001-2002 fiscal year was a difficult one. The Company was not immune to the poor U.S. business climate, as the first quarter saw the failure of HomeLife, a top 100 U.S. furniture retailer that represented business of $13 million for Shermag in 2000-2001. The resulting unpredictability reduced sales and created significant operational inefficiencies in certain factories, negatively impacting gross margins. On a more general level, the weak economy in 2001 also necessitated higher customer rebates and discounts in order to boost sales. The events of September 11th exacerbated this situation, significantly dampening the rate of order entry in the third quarter.

Cash flow from operating activities for the 2001-2002 fiscal year amounted to $24.4 million, up nearly $9 million from $15.6 million the previous year.

The Company responded to the loss of HomeLife and the economic situation in general with several initiatives. An aggressive cost cutting program was introduced in the second quarter at all levels of the operation. In order to stimulate growth in the United States, its prime market, the Company reinforced its sales structure through the appointment of a new Vice-president of Sales for the United States. This move complemented the Company's initiative, unveiled at the April 2001 High Point Furniture Market, to promote Shermag's presence in large independent furniture stores. The Company also launched new collections at the April and October Markets, which met with positive response. In addition, Shermag created a new division to import finished furniture from Asia, a growing trend in the U.S. Two new collections from this division were introduced early in 2002.

The Company was faced with the renewal of seven collective agreements during the 2001-2002 fiscal year. One resulted in a labour dispute at the Disraeli facility that reduced production and sales during the first quarter of the year. The Company also had to deal with the effects of restrictive procurement contracts that resulted in excess higher-cost log and lumber inventories in its sawmill sector. In response, the Company established a turnaround committee, replaced management, temporarily stopped production at one sawmill and strengthened the purchasing function for future log-cutting season. These efforts engendered a return to profitability for the sawmill sector during the third quarter of the year.

Twelve Months

We are pleased to report that Shermag succeeded in maintaining year-over-year sales in 2001-2002, with gross revenue of $165,657,000 compared to $164,914,000 for the previous year. The furniture sector, in a difficult year, increased its gross revenue by 3%, from $157,603,000 to $161,795,000 in 2001-2002.

Net earnings for the year, however, fell to $7,172,000 or $0.54 per share fully diluted from $13,338,000 or $1.00 per share fully diluted a year earlier. Earnings before interest, income taxes, depreciation and amortization (EBITDA) declined by $8.5 million or 29.7% to $20,218,000 in 2001-2002 from $28,744,000 for the previous year. This was attributable to a number of factors primarily related to the weak American economy.

First and foremost, gross margins fell to 27.2% from 29.4% the previous year. This was primarily due to the inefficiencies generated by the HomeLife bankruptcy and to a reduction in pricing power, including a $1.7 million increase in returns, allowances and discounts.

The HomeLife bankruptcy was also the primary factor behind the increase in selling and administrative expenses, as it generated a credit loss of $3 million. Selling and administrative expenses were also affected by non-recurrent payments associated with the termination of certain leases and employment contracts in the third quarter. Selling and administrative expenses for the year overall were 14.6% of revenues compared to 13.1% in 2000-2001.

Financial expenses grew in 2001-2002, from $473,000 in 2000-2001 to $2,288,000. This was entirely due to a $0.6 million loss on exchange that compares to a $1.9 million gain for the previous year. This $2.5 million difference was partially offset by savings of $0.7 million in interest expenses, a function of significant debt reduction and variable interest rates on most of the Company's loans

Depreciation grew in 2001-2002 to $7,492,000 from $6,561,000 in 2000-2001. During the course of the year, initiatives were taken to reduce capital spending and deferred expenditures in order to control cost of depreciation in the future.

Finally, it should be noted that the effective tax rate of 35% was higher than the rate of 32.4% for the previous year, as no income tax recovery was assumed on losses of the American sawmill subsidiary.

During the year, 108,250 common shares were issued pursuant to the exercise of stock options. At year-end, the Company had 13,292,724 common shares outstanding.

Fourth Quarter

Overall fourth quarter results showed improvement relative to the earlier quarters. After retreating 1.4% during the first three quarters, gross revenue for the fourth quarter grew 5.7% to $46,344,000 from $43,862,000 for the same period the previous year. After slipping 57.2% in the first three quarters of the year, net earnings totalled $2,921,000 or $0.22 per share fully diluted, down only 14.3% from $3,410,000 or $0.26 per share fully diluted a year earlier.

The primary factors affecting fourth quarter net earnings were a 23.8% increase in returns, allowances and discounts granted to stimulate sales, to move slow moving inventories, and a 31.8% increase in depreciation.

Selling and administrative expenses improved substantially during the fourth quarter, falling to 12.2% of revenues compared to 13.9% for the same period the previous year and 15.5% for the first three quarters of the 2001-2002 financial year. This improvement is attributable to an aggressive cost cutting program and restructuring of the sales and administration department.

MANAGEMENT'S DISCUSSION AND ANALYSIS of operating results and financial position

Shermag is able to provide for the particular needs of its factories in terms of the dimensions and types of components, thus optimizing raw-material utilization. The Company remains solidly committed to this approach, which has afforded it sustained growth and profitability.

CASH FLOW

Cash flow from operating activities for the 2001-2002 fiscal year amounted to $24,418,000, up nearly $9 million from $15,593,000 the previous year. Cash flow from operating activities for the fourth quarter of the year was up by about the same amount, at $11,035,000 compared to $2,239,000 for the same period a year ago.

There are two main reasons for this improvement. The first is a $4.9 million reduction in accounts receivable to $28,229,000 at April 5, 2002 from $33,180,000 a year earlier, achieved on steady sales. Secondly, inventories were cut by $6.3 million from $52,157,000 to $45,897,000 in 2001-2002 through better planning throughout the supply chain.

The Company used this cash flow in a manner consistent with its plan outlined last year, which called for a conservative approach to investment and a strengthened balance sheet to ensure liquidity and strength during difficult economic times.

Thus, investing activities used cash flow of $4,204,000, down from $10,804,000 for the previous year. The main uses of funds were for net capital expenditures of $2 million and deferred charges of $2.2 million. Capital expenditures were down from $8 million a year earlier in keeping with conservative capital investment and a strategy to better leverage existing operations. The deferred charges arose from products and sales tools and new projects developed to help mitigate the effects of the HomeLife bankruptcy and the weak economy and to help spur growth.

The bulk of cash flow, a net $15,136,000, was used in financing activities. The Company reduced its bank loans by nearly $16 million, and some $752,000 in cash flow was generated by the issuance of shares pursuant to the exercise of stock options.

At April 5, 2002, Shermag had cash assets of $2,827,000 compared to an overdraft of $2,251,000 at March 30, 2001.

MANAGEMENT'S DISCUSSION AND ANALYSIS of operating results and financial position

FINANCIAL POSITION

Shermag's total assets were $140,600,000 as at April 5, 2002, down from $151,974,000 at March 30, 2001. This $11.4 million decrease was in large part due to the $4.9 million decrease in accounts receivable and the $6.3 million reduction in inventories discussed previously.

Total liabilities stood at $43,078,000 at April 5, 2002, down from $62,376,000 a year ago, mainly due to debt reduction. In keeping with its plan to strengthen its balance sheet, the Company reduced bank loans and acceptances by $14,368,000 and long-term debt by $1,520,000 during fiscal 2001-2002. At year end, long-term debt stood at $9,289,000 for a long-term debt ratio of 0.09:1, compared to $10,726,000 a year earlier for a long-term debt ratio of 0.12:1.

Working capital increased by nearly $9.5 million for the year, and at April 5, 2002, stood at $55,015,000 compared to $45,426,000 a year earlier. The working capital ratio therefore improved from 2.11:1 to 3.38:1 as at April 5, 2002.

RISKS AND UNCERTAINTIES

Economic Conditions, Competition and Supply Sources

Furniture is a highly discretionary purchase and considered a vulnerable sector in times of economic contraction and instability.

An important risk in the furniture sector is the availability of Shermag's main raw material, rough timber. The Company has reduced this risk through its vertical integration strategy of acquiring hardwood sawmills through which it has ownership rights in a Timber Supply and Forest Management Agreement (CAAF) and negotiated log supply contracts.

Foreign Exchange

Exports to the United States account for approximately 72% of the Company's sales. Only a portion of the Company's raw materials and operating costs are paid in U.S. dollars. Thus the Company normally has a liquidity surplus of U.S dollars. Major fluctuations in the value of the U.S. dollar versus the Canadian dollar represent potential risk for Shermag.

To offset the negative effect of a sudden change in the exchange rate, Shermag has an internal hedging policy whereby the Company uses financial instruments such as forward exchange contracts to cover a certain percentage of its anticipated net receipts in U.S. dollars. The amount of coverage declines over time and is spread over a maximum of 24 months.

As at April 5, 2002, forward exchange contracts entered into by the Company totalled $US73 million at an average exchange rate of 1.5638, spread out over a period ending in September 2003.

In the event that it has insufficient liquidity in U.S. dollars to meet its commitments, the Company can borrow in U.S. dollars as well as Canadian dollars, or defer some foreign exchange contracts.

Environment

Like other manufacturers of wood furniture, Shermag is subject to the requirements of environmental laws and regulations pertaining to discharge and waste-disposal management. Management believes that its operations comply in all material respects with all environmental laws and regulation.

Legal Actions

Shermag is not involved in any legal actions that, in management's opinion, could have a material adverse effect on Shermag's financial position or results of operations.

OUTLOOK

Shermag entered the 2001-2002 fiscal year with a strengthened management team and solid balance sheet. The impact of initiatives taken in the first half of 2001-2002 to control inventories, cut costs and compensate for the loss of HomeLife was already evident in the fourth quarter of last year and will continue to be felt this year.

The influence of the new collections introduced during last year should also become increasingly evident as the year progresses. These added collections will allow the Company to focus on regional store chains and the independent furniture store channel, retail sectors that hold considerable potential for Shermag. The Company will continue to prioritize the development of additional retail sectors in the seasons to come.

The new division created to import finished furniture is only the first step in a strategy of leveraging existing channels of distribution by offering new product categories such as traditional styled furniture, a strategy that will be further developed in the course of this year.

There are tentative signs that the U.S. economy is improving. With its strengthened balance sheet, Shermag is well placed to take advantage of growth opportunities and overcome any negative industry trends.

MANAGEMENT'S report

Shermag Inc.'s consolidated financial statements for the years ended April 5, 2002 and March 30, 2001 and the financial information included in this annual report are the responsibility of management. The consolidated financial statements have been prepared in accordance with generally accepted accounting principles in Canada and with the policies set forth in the notes to said statements.

The Audit Committee of the Board is responsible for reviewing the consolidated financial statements in detail, for ensuring that the Company's internal control systems, management policies and accounting practices are adhered to, and for recommending approval of the consolidated financial statements to the Board of Directors.

The chartered accountants, Raymond Chabot Grant Thornton, have audited the consolidated financial statements which appear hereinafter and their report indicates the extent of their audit and their opinion on said consolidated financial statements.

Jeffrey K. Casselman
President and CEO

Josée Girard, CA
Vice-president, Finance

AUDITORS' report

To the Shareholders of Shermag Inc.

We have audited the consolidated balance sheets of Shermag Inc. as at April 5, 2002 and March 30, 2001 and the consolidated statements of earnings, retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at April 5, 2002 and March 30, 2001 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Raymond Chabot Grant Thornton

General Partnership
Chartered Accountants

Sherbrooke, Québec
May 16, 2002

Shermag inc.

CONSOLIDATED FINANCIAL STATEMENTS

2001 | 2002

CONSOLIDATED earnings

Years ended April 5, 2002 and March 30, 2001
(Amounts in thousands of dollars, except earnings per common share)

	2002-04-05 (53 weeks)	2001-03-30 (52 weeks)
	$	$
Gross revenue	**165,657**	164,914
Less: returns, allowances and discounts	**12,860**	11,168
Net revenue	**152,797**	153,746
Cost of sales	**107,799**	105,310
Gross profit excluding depreciation and amortization	**44,998**	48,436
Selling and administrative expenses	**24,182**	21,671
Financial expenses	**2,288**	473
Depreciation and amortization	**7,492**	6,561
	33,962	28,705
Earnings before income taxes	**11,036**	19,731
Income taxes (Note 6)	**3,864**	6,393
Net earnings	**7,172**	13,338
Earnings per common share (Note 7)		
Basic	**0.54**	1.01
Diluted	**0.54**	1.00

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED retained earnings

Years ended April 5, 2002 and March 30, 2001
(Amounts in thousands of dollars)

	2002-04-05 (53 weeks)	2001-03-30 (52 weeks)
	$	$
Balance, beginning of year	**52,030**	38,794
Net earnings	**7,172**	13,338
	59,202	52,132
Premium on redemption of common shares		102
Balance, end of year	**59,202**	52,030

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED cash flows

Years ended April 5, 2002 and March 30, 2001
(Amounts in thousands of dollars)

	2002-04-05 (53 weeks)	2001-03-30 (52 weeks)
	$	$
OPERATING ACTIVITIES		
Net earnings	**7,172**	13,338
Non-cash items		
Depreciation and amortization	**7,492**	6,561
Amortization of deferred credits	**(229)**	(248)
Loss on disposal of assets	**73**	
Future income taxes	**12**	887
Changes in working capital items (Note 5)	**9,898**	(4,945)
Cash flows from operating activities	**24,418**	15,593
INVESTING ACTIVITIES		
Fixed assets	**(2,096)**	(7,958)
Disposal of fixed assets	**112**	17
Deferred charges	**(2,220)**	(2,863)
Cash flows from investing activities	**(4,204)**	(10,804)
FINANCING ACTIVITIES		
Net change in bank loans and acceptances	**(14,368)**	(6,883)
Instalments on long-term debt	**(1,520)**	(776)
Issues of shares	**752**	
Redemption of shares		(170)
Cash flows from financing activities	**(15,136)**	(7,829)
Net increase (decrease) in cash and cash equivalents	**5,078**	(3,040)
Cash and cash equivalents, beginning of year	**(2,251)**	789
Cash and cash equivalents, end of year	**2,827**	(2,251)

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED balance sheets

April 5, 2002 and March 30, 2001
(Amounts in thousands of dollars)

	2002-04-05	2001-03-30
	$	$
ASSETS		
Current assets		
Cash and cash equivalents	**2,827**	
Accounts receivable (Note 8)	**28,229**	33,180
Income taxes receivable	**339**	274
Inventories (Note 9)	**45,897**	52,157
Prepaid expenses	**879**	750
Future income taxes (Note 6)		42
	78,171	86,403
Fixed assets (Note 10)	**58,318**	61,119
Other assets (Note 11)	**3,499**	4,059
Future income taxes (Note 6)	**612**	393
	140,600	151,974
LIABILITIES		
Current liabilities		
Outstanding cheques		2,251
Bank loans and acceptances (Note 12)	**5,759**	20,127
Accounts payable and accrued liabilities	**15,471**	15,793
Income taxes payable	**499**	1,296
Instalments on long-term debt	**1,427**	1,510
	23,156	40,977
Long-term debt (Note 13)	**9,289**	10,726
Future income taxes (Note 6)	**7,169**	6,980
Deferred credits	**3,464**	3,693
	43,078	62,376
SHAREHOLDERS' EQUITY		
Capital stock (Note 14)	**38,320**	37,568
Retained earnings	**59,202**	52,030
	97,522	89,598
	140,600	151,974

The accompanying notes are an integral part of the consolidated financial statements.

On behalf of the Board,

Jeffrey K. Casselman
Director

Arthur P. Earle
Director

April 5, 2002 and March 30, 2001
(Amounts in the tables are in thousands of dollars)

1 - GOVERNING STATUTES AND NATURE OF OPERATIONS

The Company, incorporated under Part IA of the Companies Act (Québec), manufactures furniture.

2 - CHANGE IN ACCOUNTING POLICY

The Company adopted, on a retroactive basis, the new recommendations of the Canadian Institute of Chartered Accountants with respect to Section 3500 "Earnings per share". Under the new recommendations, the treasury stock method is to be used, instead of the current imputed earnings approach, for determining the dilutive effect of stock options. All prior diluted earnings per share amounts have been recalculated in accordance with the new requirements. Such recalculations did not result in any change to the reported diluted earnings per common share for the year ended March 30, 2001.

3 - ACCOUNTING POLICIES

Principles of consolidation

The financial statements include the accounts of the Company and its wholly-owned subsidiaries.

Cash and cash equivalents

The Company's policy is to present cash and temporary investments having a term of less than three months from the acquisition date with cash and cash equivalents.

Inventory valuation

Finished goods and goods in process are valued at the lower of cost and net realizable value. Cost is determined by the average cost method.

Raw materials and supplies are valued at the lower of cost and replacement cost. Cost is determined by the first in, first out method.

Depreciation and amortization

Fixed assets are depreciated over their estimated useful lives according to the following methods, periods and annual rates:

	Methods	Rates and periods
Buildings	Straight-line	40 years
Machinery and equipment	Diminishing balance	10%
Rolling stock, software	Diminishing balance	30%
Office furniture	Diminishing balance	20%
Leasehold improvements	Straight-line	5 years
Forestry properties	Straight-line	25 years

Deferred charges are amortized according to the straight-line method over periods not exceeding five years.

Goodwill represents the excess of cost over the fair value of net assets acquired, and is amortized according to the straight-line method over a period of ten years until 2003. The valuation and amortization of goodwill are revised regularly by management to ensure that no decrease in the value has occurred, by comparing the accounting value with the non-actualized future cash flows generated by those assets.

Deferred credits represent government grants and investment tax credits resulting from the acquisition of fixed assets. The grants and tax credits are accounted for as deferred credits and amortized according to the same annual methods and rates as the assets to which they relate are depreciated.

Income taxes

The Company uses the tax liability method to account for income taxes. Under this method, future tax assets and liabilities are determined according to differences between their respective carrying amounts and tax bases. They are measured by applying enacted or substantively enacted tax rates and laws at the date of the financial statements for the years in which the temporary differences are expected to be recovered or settled.

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of the contingent assets and liabilities and the reported amounts of revenue and expenses. Actual results could differ from these estimates.

April 5, 2002 and March 30, 2001
(Amounts in the tables are in thousands of dollars)

3 - ACCOUNTING POLICIES (CONTINUED)

Earnings per share

Basic earnings per common share are computed by dividing the net earnings available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share are calculated giving effect to the potential dilution that would occur if securities or other contracts to issue common shares were exercised or converted to common shares at the later of the beginning of the year or the issuance date. The treasury stock method is used to determine the dilutive effect of stock options. The treasury stock method assumes that proceeds received from the exercise of in-the-money stock options are used to repurchase common shares at the average market price during the period.

Stock option plan

No equity sharing expense is recognized when stock options are issued under the Company's stock option plan. Any consideration paid on exercise of stock options will be credited to capital stock.

Foreign currency translation

Monetary assets and liabilities in foreign currency are translated at exchange rates in effect at the balance sheet dates, whereas other assets and liabilities are translated at exchange rates in effect at transaction dates. Revenue and expenses in foreign currency are translated at the monthly average rate in effect, with the exception of depreciation, which is translated at the historical rate. Gains and losses are included in the earnings for the years.

Assets and liabilities of the self-sustaining foreign subsidiary are translated into Canadian dollars at the exchange rate in effect at the balance sheet dates. Revenue and expenses are translated at the average rate in effect during the years. Gains and losses are included in the "Accumulated exchange adjustments" account of the shareholders' equity, if applicable.

Forward exchange contracts

The Company enters into foreign exchange contracts to manage its currency risk exposure. These financial instruments are presented at cost. Positions hedged by foreign exchange contracts are converted using the contract rate and the gains or losses are recognized to earnings during the years in which the revenue or expenses resulting from the corresponding hedged position are recorded.

4 - INFORMATION INCLUDED IN THE STATEMENT OF EARNINGS

	2002-04-05 (53 weeks)	2001-03-30 (52 weeks)
	$	$
Depreciation of fixed assets	**4,712**	4,563
Amortization of deferred charges	**2,720**	1,944
Amortization of goodwill	**60**	54
Amortization of deferred credits	**229**	248
Interest on short-term debt	**1,173**	1,518
Interest on long-term debt	**517**	934
Loss (gain) on foreign exchange	**598**	(1,979)

5 - INFORMATION INCLUDED IN THE STATEMENT OF CASH FLOWS

The changes in working capital items are detailed as follows:

	2002-04-05 (53 weeks)	2001-03-30 (52 weeks)
	$	$
Accounts receivable	**4,951**	(2,115)
Income taxes receivable	**(65)**	
Inventories	**6,260**	(3,053)
Prepaid expenses	**(129)**	92
Accounts payable and accrued liabilities	**(322)**	821
Income taxes payable	**(797)**	(690)
	9,898	(4,945)

Cash flows relating to interest and income taxes on operating activities are detailed as follows:

	2002-04-05 (53 weeks)	2001-03-30 (52 weeks)
	$	$
Interest paid	**1,696**	2,803
Income taxes paid	**4,714**	6,196

April 5, 2002 and March 30, 2001
(Amounts in the tables are in thousands of dollars)

6 - INCOME TAXES

a) Provision

	2002-04-05 (53 weeks)	2001-03-30 (52 weeks)
	$	$
Income taxes are detailed as follows:		
Current	**3,852**	5,506
Future	**12**	887
	3,864	6,393

The difference between the Company's effective income tax rate and the combined Federal and Provincial income tax rate in Canada is explained as follows:

	2002-04-05	2001-03-30
	%	%
Income taxes at the combined Federal and Provincial income tax rate in Canada	**39.2**	39.6
Manufacturing and processing profits deduction	**(6.8)**	(6.8)
Future income tax benefit not recorded	**1.8**	
Permanent differences and other	**0.8**	(0.4)
Income taxes at the Company's effective income tax rate	**35.0**	32.4

b) Future tax assets and liabilities

Futures taxes reflect the net impact of timing differences between the value of assets and liabilities for accounting and tax purposes. The main components of the Company's future tax assets and liabilities are as follows:

	2002-04-05	2001-03-30
Future tax assets	**$**	$
Provision deductible for tax purposes only when actually disbursed		42
Losses carry-forward for tax purposes	**612**	393
	612	435
Future tax liabilities		
Book value in excess of tax basis		
Fixed assets	**6,662**	6,475
Deferred charges	**507**	505
	7,169	6,980

The future income tax asset resulting from allowable capital losses is not recorded in the financial statements. These losses amount to $1,832,000 and may be carried-forward and applied against taxable capital gains over an indefinite period.

7 - EARNINGS PER SHARE

The following table shows a reconciliation between basic earnings per common share and diluted earnings per common share:

	2002-04-05 (53 weeks)	2001-03-30 (52 weeks)
Net earnings	**$7,172**	$13,338
Weighted average number of common shares outstanding	**13,209,945**	13,193,298
Effect of dilutive stock option	**113,539**	299,855
Weighted average diluted common shares outstanding	**13,323,484**	13,493,153
Basic earnings per common share	**$0.54**	$1.01
Diluted earnings per common share	**$0.54**	$1.00

April 5, 2002 and March 30, 2001
(Amounts in the tables are in thousands of dollars)

8 - ACCOUNTS RECEIVABLE

	2002-04-05	2001-03-30
	$	$
Trade accounts		
Canada	**6,963**	7,128
United States	**20,149**	24,518
	27,112	31,646
Sales taxes receivable	**740**	987
Others	**377**	547
	28,229	33,180

90% of the trade accounts receivable are secured by a global multirisk insurance policy upon shipping (80 % of the United States trade accounts receivable in 2001).

9 - INVENTORIES

	2002-04-05	2001-03-30
	$	$
Finished goods	**20,204**	19,984
Goods in process	**10,803**	12,937
Raw materials	**13,339**	17,768
Supplies	**1,551**	1,468
	45,897	52,157

10 - FIXED ASSETS

			2002-04-05
	Cost	**Accumulated depreciation**	**Net**
	$	**$**	**$**
Land	**2,078**		**2,078**
Buildings	**30,267**	**5,587**	**24,680**
Machinery and equipment	**43,380**	**17,866**	**25,514**
Rolling stock	**1,280**	**782**	**498**
Office furniture	**5,896**	**3,872**	**2,024**
Software	**4,941**	**2,720**	**2,221**
Leasehold improvements	**949**	**189**	**760**
Forestry properties	**696**	**153**	**543**
	89,487	**31,169**	**58,318**

			2001-03-30
	Cost	Accumulated depreciation	Net
	$	$	$
Land	2,175		2,175
Buildings	30,127	4,841	25,286
Machinery and equipment	42,218	15,400	26,818
Rolling stock	1,463	845	618
Office furniture	5,641	3,465	2,176
Software	4,585	2,014	2,571
Leasehold improvements	1,018	112	906
Forestry properties	696	127	569
	87,923	26,804	61,119

April 5, 2002 and March 30, 2001
(Amounts in the tables are in thousands of dollars)

11 - OTHER ASSETS

	2002-04-05	2001-03-30
	$	$
Deferred charges, at amortized cost		
New product development costs	**1,111**	1,574
Pre-operating costs	**1,007**	850
Promotional tools	**1,284**	1,440
Financing charge	**50**	88
	3,452	3,952
Goodwill, at amortized cost	**47**	107
	3,499	4,059

12 - BANK LOANS AND ACCEPTANCES

The Company has total authorized operating credits of $32,500,000, which can be used as bank loans or acceptances. These amounts can be drawn out in Canadian or American dollars. The bank loans bear interest at prime rate or U.S. prime rate, and this rate is reviewed on a quarterly basis. The bank acceptances are at the market rate. The operating credits are established for a three-year term, renewable on September 30 of each year for an additional year and are subject to the restrictions mentioned in Note 13 (*).

13 - LONG-TERM DEBT

	2002-04-05	2001-03-30
	$	$
Loan, prime rate plus 0.5%, payable in quarterly capital instalments of $300,000, maturing no later than 2003 (*)	**9,800**	11,000
Non-interest bearing loans, payable in monthly and annual instalments, maturing at various dates until 2007	**916**	1,093
Loans, prime rate plus 1.25%		61
Loan, lender's prime rate		82
	10,716	12,236
Instalments due within one year	**1,427**	1,510
	9,289	10,726

(*) This loan and the short-term bank loans and acceptances are secured by a first rank mortgage on the universality of all present and future movable and immovable, tangible and intangible assets, for an amount of $70,000,000. The Company is subject to certain restrictions under the credit agreement. The Company was in compliance with these restrictions as at April 5, 2002.

The instalments on long-term debt for the next five years are $1,426,795 in 2003, $8,826,780 in 2004, $216,820 in 2005, $200,455 in 2006 and $45,443 in 2007.

April 5, 2002 and March 30, 2001
(Amounts in the tables are in thousands of dollars)

14 - CAPITAL STOCK

Authorized

Unlimited number of common shares, without par value, voting and participating

Unlimited number of preferred shares of first and second rank, without par value, which can be issued in one or more series, for which the directors will determine their number, designation, rights, privileges, conditions and restrictions

Preferred shares of second rank, series 1, annual and non-cumulative dividend of $0.06 per share, non-voting, non-participating, redeemable at the Company's option at the paid-up capital amount

	2002-04-05		2001-03-30	
	Number of shares	**Amount**	Number of shares	Amount
		$		$
Issued and fully paid				
Common shares				
Balance, beginning of year	**13,184,474**	**37,119**	13,208,774	37,187
Stock options exercised for cash	**108,250**	**752**		
Redemption of shares for cash			(24,300)	(68)
Balance, end of year	**13,292,724**	**37,871**	13,184,474	37,119
Preferred shares of second rank, series 1				
Balance, beginning and end of year	**700,000**	**449**	700,000	449
		38,320		37,568

The Company has reserved 800,000 common shares that can be issued by way of the stock option plan for directors and officers. Of this number and since the inception of the plan, 111,250 options have been exercised. The period, terms and conditions of these options are determined by the Board of Directors provided that the options expire at the latest ten years following the date they are granted.

The Company's stock option plan is as follows:

	2002-04-05		2001-03-30	
	Options	**Weighted average exercise price**	Options	Weighted average exercise price
		$		$
Options outstanding, beginning of year	**729,500**	**9.00**	336,500	12.76
Granted			435,000	6.48
Exercised	**(108,250)**	**6.95**		
Cancelled	**(7,000)**	**10.73**	(2,000)	13.80
Expired			(40,000)	13.20
Options outstanding, end of year	**614,250**	**9.33**	729,500	9.00

Summary of options outstanding at April 5, 2002:

		Total outstanding		Total exercisable	
Options	Exercise price	Weighted average exercise price	Contractual remaining life	Options	Weighted average exercise price
	$	$			$
380,000	6.25 - 9.00	6.41	7.6 years	157,500	6.52
234,250	13.20 - 17.00	14.07	5.1 years	234,250	14.07

April 5, 2002 and March 30, 2001
(Amounts in the tables are in thousands of dollars)

15 - COMMITMENTS

The Company has entered into long-term lease agreements, expiring at the latest in 2005, which call for lease payments of $2,092,887 for the rental of premises. Minimum lease payments for the next years are $612,844 in 2003, $595,877 in 2004, $598,906 in 2005 and $285,260 in 2006.

16 - FAIR VALUE OF THE FINANCIAL INSTRUMENTS

Primary financial instruments

Cash and cash equivalents, accounts receivable, outstanding cheques, bank loans and acceptances, accounts payable and accrued liabilities are short-term financial instruments whose fair value approximates their carrying amount given that they will mature shortly.

The estimated fair value of the Company's long-term debt is determined based on analysis of the discounted value of cash flows, using interest rates in effect for the Company's similar borrowing agreements. The carrying amount is $10,716,293 ($12,236,433 as at March 30, 2001) and there is no material difference with the fair value.

Derivative financial instruments

As at April 5, 2002, the Company is committed, by virtue of forward exchange contracts, to sell $73,000,000 ($90,600,000 as at March 30, 2001) U.S. dollars for Canadian dollars. The fair value of the derivative financial instruments is determined based on prices obtained from the Company's brokers for identical or similar financial instruments. The favorable (unfavorable) fair value of these forward exchange contracts are detailed as follows:

			2002-04-05
Term	**$US**	**Average rate**	**Fair value**
	$		**$**
1 to 12 months	**61,000**	**1.5559**	**(2,550)**
13 to 18 months	**12,000**	**1.6041**	**29**
	73,000	**1.5638**	**(2,521)**

			2001-03-30
	$US	Average rate	Fair value
	$		$
1 to 12 months	69,600	1.4637	(7,821)
13 to 18 months	21,000	1.4971	(1,657)
	90,600	1.4714	(9,478)

17 - GEOGRAPHIC BREAKDOWN OF REVENUE

The Company's revenue can be broken down geographically as follows:

	2002-04-05 (53 weeks)	2001-03-30 (52 weeks)
	$	$
Canada	**45,912**	36,093
United States	**119,745**	128,821
	165,657	164,914

BOARD OF DIRECTORS

Claude Pichette [1]
Chairman of the Board
Shermag Inc.

Jeffrey K. Casselman [1]
President and
Chief Executive Officer
Shermag Inc.

Charles Chamard [2] [3]
Corporate Director

Arthur P. Earle, C.M., FICI [1] [2]
Consultant

Jean-Côme Gaudet [2]
Management Consultant

John D. Thompson [1] [3]
Deputy Chairman
Montréal Trust

Jeanne Wojas [3]
Lawyer and Corporate Director

(1) Member of the Executive Committee
(2) Member of the Audit Committee
(3) Member of the Human Resources Committee

MANAGEMENT

Jeffrey K. Casselman
President and
Chief Executive Officer

Larry Beasley
Vice-president, Marketing

Josée Bélanger
Corporate Secretary

Guy Cardinal
Vice-president, Production

Josée Girard
Vice-president, Finance

Robert Régimbald
Vice-president
Customer Service & Logistics

CORPORATE INFORMATION

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Sherbrooke (Québec)

Bank
National Bank of Canada

Stock Registration
Shermag Inc.'s shares are listed on the Toronto Stock Exchange under symbol SMG.

Annual Information Form and General Information
To obtain a copy of the Annual Information Form submitted to the Québec Securities Commission and the Ontario Securities Commission or for any additional information regarding the Company, please send a written request to the Company's Secretary or to the Transfer Agent.

Annual and Special General Meeting of Shareholders
Wednesday, August 21, 2002
at 10:00
Marriott Château Champlain
Salon Viger AB
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Montréal (Québec)

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